quinn emanuel trial lawyers | london
90 High Holborn, London WC1V 6LJ, United Kingdom | TEL +44 20 7653 2000 FAX +44 20 7653 2100

WRITER'S DIRECT DIAL NO.
[redacted]

WRITER'S INTERNET ADDRESS
[redacted]

20 June 2022

BY EMAIL ONLY

The Financial Supervisory Authority of Norway ("FSAN")
Revierstredet 3
0151 Oslo
Norway
FAO: Jon Hellevik, Supervisory Department

Dear Sirs,

DNB Bank ASA – Legacy Perpetual Bonds

1. We write to you on behalf of an *ad hoc* committee of noteholders who are holders of, or representatives of funds and accounts that are holders of notes with ISIN numbers LU0001344653, GB0040940875, and GB0042636166 (the **"Notes**" or the **"Bonds**")(our "**Clients**"). Our Clients hold at least 20% of the outstanding Notes in respect of each of the issues set out below.

2. The Notes were issued as part of: (a) Den norske Creditbank's two issuances of Primary Capital Perpetual Floating Rate Notes in 1985 and 1986 (the "**DNB Notes**"), and (b) Bergen Bank's issuance of Perpetual Floating Rate Notes (the "**Bergen Notes**"), with right to subordinate in 1986. As a successor to Den norske Creditbank and Bergen Bank, DNB Bank ASA ("**DNB**" or the "**Bank**") has assumed all obligations and liabilities arising out of the Notes, as set out in the Proposal for an issue of the Notes and its Appendices ("**Proposals**").

3. We write with reference to, and to draw to the attention of the Financial Supervisory Authority of Norway (the "**FSAN**") a presentation given by the Bank on 10 February 2022, which included an update as to its Q4 2021 Results (the "**Presentation**").[1] We refer in particular to slide 23 of the Presentation, which relates to legacy perpetual

[1] A copy of the Presentation is enclosed with this letter.

bonds, including the Notes held by our Clients. The content of this Presentation was, and remains, of serious concern to our Clients. Specifically:

a. DNB announced that, for the purposes of the Banking Package, the Bonds would be treated as Tier 2 capital. It further notified investors of the intention to keep the bonds as "regular funding" in the event of the bonds being unable to qualify as Tier 2 capital; and

b. it announced the Bank's intention, in light of the cessation of LIBOR, to adopt an alternative method of calculating the coupon on the bonds, such that they in effect become fixed rate bonds, with the most recent coupon being repeated.

4. Whilst we intend to write separately to the Bonds' Trustee in relation to the second of those issues, the purpose of this letter is to draw our Clients' serious concerns as to the first of these issues to the attention of FSAN, in its role as the relevant competent authority and the national resolution authority, and to state that it is our Clients' firm view that the Notes are incompatible with the applicable legislation in Norway and that DNB (given its systemic importance in Norway) should be required to call the Notes immediately. This is for the following reasons:

a. the Notes do not satisfy the requirements of Tier 2 instruments under Directive 2019/879/EU on various grounds, most notably because they are governed by the law of a third country and do not provide for a contractual bail-in mechanism, which in turn affects the FSAN's powers as Norway's national resolution authority to effectively exercise its write-down and conversion powers and to apply the bail-in tool;

b. the Notes should be excluded from any calculation of the Bank's minimum requirements for own funds and eligible liabilities ("**MREL**") because there is no contractual bail-in mechanism;

c. the Notes also represent an 'infection risk' to the rest of Tier 2 bonds ("**Other Tier 2 bonds**") that rank *pari passu* to the Notes. This is because the holders of Other Tier 2 bonds would be subordinated to the Notes in that they were subject to different treatment if the FSAN applied the bail-in tool in a resolution context. This would, in turn, likely lead to material litigation and would undermine the principles of legal certainty and transparency that are central to bank recovery and resolution mechanisms. Since this outcome represents an impediment to resolution and swift recapitalisation of banks, national resolution authorities, such as the FSAN, are expected to exercise their powers to compel banks to call such bonds and replace them with regulatory capital that allows for a swift and effect resolution action; and

d. there is a risk that any measure under Norwegian law that is intended to compromise a contractual debt governed by English law may not be recognised in the English courts, thereby further undermining the FSAN's ability to apply effectively its recovery and resolutions power. As such, the FSAN should immediately call the Bonds and remove the impediments to the resolution of DNB.

5. These arguments are elaborated upon in the remainder of this letter. To that end:

a. this letter will **first** discus the need and importance of every financial institution operating in the European Union (the "**EU**") or in the European Economic Area (the "**EEA**") having adequate regulatory capital that can be written-down and converted and / or bailed-in;

b. **second**, the letter will seek to demonstrate that the Notes cannot be classified as Tier 2 capital instruments and cannot effectively be bailed-in or written-down and converted as required by the applicable legislation;

c. **third**, the letter will seek to explain why the Notes represent an infection risk and an impediment to resolution, which is why the Bank should be required to call them and replace them with adequate regulatory capital;

d. **fourth**, the letter sets out the possibility of the Notes constituting an impediment to resolution as a result of the complications associated with issuances including a retail distribution; and

e. **finally**, we will explain that, as a matter of the governing law of the Notes, the Notes may not be able to be converted and written-down.

The need for regulatory capital that the FSAN can write-down, convert or bail-in to recapitalise DNB and the FSAN's powers in achieving the objectives of the resolution mechanism

6. The 2008 financial crisis exposed the inevitable tension between the need to guarantee the financial and economic stability and the need to avoid spending taxpayers' money to preserve the continuity of critical financial functions. To achieve this objective, the institutions of the European Union ("**EU**"), in addition to the Basel Committee on Banking Supervision and the Financial Stability Board (the "**FSB**"), have for at least the past ten years, been heavily invested in adopting measures that would minimise taxpayers' exposure to the need of strengthening the capital of systemically important financial institutions. For this purpose, the EU institutions passed a number of laws to tackle this issue, including Regulation (EU) No 575/2013 on prudential requirements (the "**Capital Requirements Regulations**" or the "**CRR I**") and Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions (the "**Bank Recovery and Resolution Directive**" or the "**BRRD I**"), which specified that to tackle the issue of governmental bail-outs a regime was needed to provide national authorities with "*a credible set out tools to intervene sufficiently early and quickly in an unsound and failing institutions so as to ensure the continuing of the institution's critical financial and economic functions, while minimising the impact of an institution's failure on the economy and financial system*" (BRRD I, Recital 5).

7. Advanced resolution planning was hailed as "*an essential component of effective resolution*" (BRRD 1, Recital 25), which meant that national resolution authorities, such as the FSAN, were and are expected to consider in advance the available and appropriate resolution strategies and tools for every financial institution they supervise, in particular those institutions that are of systemic importance to the relevant market. Indeed, Recital 29 of the BRRD I stipulates that national resolution authorities "*should have the power … to take measures which are necessary and proportionate to reduce or remove material impediments to the application of resolution tools and ensure the resolvability of the entities concerned*" and adds that particularly in cases of systemic

institutions, "*it is crucial, in order to maintain financial stability, that authorities have the possibility to resolve any institution*".

8. An innovative way of addressing failing credit institutions or those institutions in need of additional capital, but without drawing on public resources, was through the development of the "bail-in" mechanism. As explained in the BRRD I:

> "*the bail-in tool achieves that objective by ensuring that shareholders and creditors of the failing institutions suffer appropriate losses and bear an appropriate part of the costs arising from the failure of the institution. The bail-in tool will therefore give shareholders and creditors of institutions a stronger incentive to monitor the health of an institution during normal circumstances and meets the Financial Stability Board recommendation that statutory debt-write down and conversion powers be included in a framework for resolution, as an additional option in conjunction with other resolution tools.*"

9. In line with this objective, having capital instruments that allow national resolution authorities, such as the FSAN, to write them down, convert them and potentially cancel them is mission-critical to the success of the recovery and resolution mechanism established by the EU, in particular to the application of the bail-in tool or the write-down and conversion powers pursuant to Chapter V of the BRRD I. In fact, the BRRD I emphasised the importance of these capital instruments by stating that "*resolution authorities should be required to write down those instruments [i.e., Additional Tier 1 and Tier 2 capital instruments] in full, or covert them to Common Equity Tier 1 instruments, at the point of non-viability and before any resolution action is taken*" (Recital 81). Further, the BRRD I envisioned that "*the fact that the instruments are to be written down or converted in the circumstances required by this Directive should be recognised in the terms governing the instrument, and in any prospectus or offering documents published or provided in connection with the instruments*". Unsurprisingly in the present case, the Proposals[2] did not specify this possibility in relation to the Notes, which were issued long before these integral pieces of EU legislation that have revolutionised and streamlined the supervisory framework of financial institutions in the EU.

10. These objectives are in line with the recommendations from the FSB. As the EU is a G20 member, the FSB's guidance is relevant for the EU's internal market. Indeed, it is due to the FSB's "Principles on Loss-Absorbing and Recapitalisation Capacity"[3] that the EU revised the BRRD I (resulting in Directive (EU) 2019/879 or the "**BRRD II**") and the CRR I (resulting in Regulation (EU) 2019/876 or the "**CRR II**") to take into account the new recommendation concerning the so-called Total Loss-Absorbing Capacity Term Sheet (the "**TLAC**") and MREL. In circumstances where the BRRD II and the CRR II enter into force today, 20 June 2022, in Norway, the FSB's

[2] The Proposals refers to proposals for the issuance of the Notes, which set out the Notes' contractual terms. They should be read in conjunction with other contractual arrangements, such as the trust deeds.

[3] Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution: Total Lossabsorbing Capacity (TLAC) Term Sheet (fsb.org)

recommendations contain highly relevant guidance that the FSAN should take into account.

11. Among those principles, two stand out as particularly relevant:

    a. *The principle of legal certainty*: Exposing instruments eligible for minimum TLAC to loss should be legally enforceable, and should not give rise to systemic risk or disruption to the provision of critical functions. More specifically, the FSB explains that:

> "*given that TLAC-eligible instruments will need to absorb losses and contribute to recapitalisation needs in order for an orderly resolution to take place, there is a particular need to ensure that authorities possess the necessary legal powers to expose the TLAC-eligible instruments to loss and* ***that they can exercise their powers without material risk of successful legal challenge or giving rise to compensation costs under the "no creditor worse off than in liquidation"*** *(NCWOL) principle. ……. Any instruments or liabilities that cannot be written down or converted into equity by the relevant resolution authority without giving rise to material risk of NCWOL claims should not be eligible as TLAC*" (emphasis added).

    The same principle is repeated in Article 72(b)(4)(e) of the CRR II with respect to eligible liabilities instruments.

    b. *The principle of transparency*: investors, creditors, counterparties, customers and depositors should have clarity about the order in which they will absorb losses in resolution. The FSB strongly encourages that "*there is as much clarity as possible ex ante about how losses are absorbed and recapitalisation is effect in the resolution of cross-border groups*".

12. The capacity to absorb loss cannot realistically be achieved without resolution authorities, such as the FSAN, doing away with impediments to resolvability and resolution. Recital 29 of the BRRD I recognises that "*[r]esolution authorities … should have the power to require changes to the structure and organisation of institutions directly or indirectly through the competent authority, to take measures which are necessary and proportionate to reduce or remove material impediments to the application of resolution tools and ensure the resolvability of the entities concerned*". Thus, any capital instrument that cannot be written-down or bailed-in, or which give rise to risks of financial infection, in particular through the application of their contractual terms, should be addressed by the FSAN through an order to the relevant institution.

13. There is no doubt that DNB is systemically important to the stability of the Norwegian financial market. Whilst DNB is not considered a global systemically important institution, it is considered an 'Other- Systemically Important Institution' (O-SIII) by

the European Systemic Risk Board. This systemic importance arises from the systemic activities it undertakes domestically. In this respect, we note that it is the only Norwegian bank required to maintain a 2% O-SIII buffer.[4] DNB also reports that it is required to hold a systemic risk buffer of 4.5% on Norwegian exposures such that its '*effective systemic risk buffer is 3.16%*'.[5]

14. Because of its systemic importance, it is probable that a resolution of DNB would require the use of a resolution tool that requires burden sharing from creditors. This could be either through the application of the bail-in tool or though the FSAN's exercise of its write-down and conversion powers pursuant to Article 59 of the BRRD II. In order to avoid the burden of recapitalisation falling on the taxpayer through a bail-out (and in that respect, we note a complication in that the Norwegian government is a major shareholder in DNB), systemically important institutions are required to hold sufficient MREL to (i) absorb losses, and (ii) recapitalize the Bank to a level at which it would restore market confidence. Indeed, consistent with the original objectives of bank resolution, the FSB's Term Sheet on the TLAC requirements states that systemic banks must holding enough regulatory capital to ensure that "*critical functions can be continued without taxpayers' funding (public funds) or financial stability being put at risk*".[6] Specifically, this means that:

    a. the regulatory capital of the bank (including the T2 capital) should be at a level sufficient to meet these losses; and

    b. the recapitalization amount (all Common Equity Tier 1) is required to be sufficient to restore a total capital ratio of 8% plus any pillar 2 requirement set.

15. If the FSAN has concerns about loss absorbency, then the Notes should be excluded from an assessment of the MREL standard and / or as Tier 2 bonds, as explained below. This concern could arise through features of the Notes that may present a legal challenge to a decision to bail-in those securities or write-down down and convert them.

16. In the upshot, the capital instruments that any Norwegian financial institution claims qualify as Additional Tier 1 or Tier 2 instruments or eligible for the TLAC and the MREL requirements must now satisfy the FSAN as having the characteristics that allow the FSAN to write-them down fully, convert and cancel them either as part of the FSAN's conversion powers under Article 59 of the BRRD II or under the application of the bail-in tool. Additionally, they must satisfy the FSAN that they do not represent any impediment to resolvability. Absent these capabilities, these capital instruments become inadequate for resolution purposes and can no longer legally be claimed to satisfy the characteristics of Tier 2 instruments or MREL requirements, as required by the applicable EU, and in turn, Norwegian legislation.

17. To advance the goals of financial stability through the application of the write-down and conversion powers and the bail-in tool, the BRRD II gives national resolution authorities a power to address or remove impediments to resolvability. Specifically, Article 17(j) of the BRRD II provides the FSAN with the power to require DNB to

---

4 Norway (europa.eu)

5 Capital annex (Q4 2021 Results Feb 2022), page 14

6 Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution: Total Loss-absorbing Capacity (TLAC) Term Sheet (fsb.org), p. 9

"*renegotiate any eligible liability, Additional Tier 1 or Tier 2 instrument it has issued, with a view to ensuring that any decision of the resolution authority to write down or convert that liability or instrument would be effected under the law of the jurisdiction governing that liability or instrument*".

18. For the reasons set out below, the FSAN should exercise this power in relation to the Notes issued by the Bank, as they do not satisfy the capital adequacy requirements and pose an impediment to the effective exercise of resolution powers.

The Notes do not satisfy the requirements of the Tier 2 classification

19. The Presentation states that the Notes held by our Clients are classified as Tier 2. It is wholly unsatisfactory that the Bank has not, to date, explained the reasons why it considers the Notes to qualify as such, despite the investors' entitlement to an understanding of how their investments may be impacted in the resolution context. This also contravenes the requirement in the BRRD to forewarn investors that their instruments may, in certain circumstances, be written-down and converted. The FSAN should, as a matter of urgency, request the Bank to provide this explanation.

20. In any event, in order to classify as Tier 2, the Bonds must now satisfy the requirements of Article 63 of the CRR II. Of particular interest are the following provisions that must be satisfied in order to classify the Notes as Tier 2 instruments:

    a. **Article 63(d),** which states that the claim on the principal amount of the instruments under the provisions governing the instruments ranks below any claim from eligible liabilities instruments;

    b. **Article 63(f),** which prohibits any "*arrangements that otherwise enhances the seniority of the claim under the instruments*";

    c. **Article 63(k),** which provides that the applicable documentation cannot contain provisions that indicate explicitly or implicitly that the instruments would be called, redeemed, repaid or repurchased early, as applicable, by the institution other than in the case of the insolvency or liquidation of the institution and the institution does not otherwise provide such an indication.

21. The Notes do not satisfy these requirements, which makes them ineligible for the Tier 2 classification. By way of illustrative examples:

    a. Under English law, the Notes cannot automatically be written down on a permanent basis or converted into CET1 instruments. Following the United Kingdom's exit from the EU, this risk is more than minimal. The FSAN may find instructive a policy paper by the SRB where the SRB explained that:[7]

> "*The legal enforceability and effectiveness of contractual recognition* ***is conditional upon any unconditional contractual acceptance of an EU resolution action not being overturned or rendered ineffective by the laws or actions of***

[7] Minimum Requirement for Own Funds and Eligible Liabilities (MREL) / SRB Policy under the Banking Package (europa.eu), paragraph 109.

> ***authorities having jurisdiction over the contract***. *As acknowledged in the FSB's Principles for Cross-border Effectiveness of Resolution Actions, contractual approaches such as bail-in clauses do not achieve the level of legal certainty that would be conferred by statutory recognition*" (emphasis added).

One solution to address this issue has been a contractual bail-in mechanism. However, this mechanism is inapplicable in the present case, as the Notes contain no provision for a contractual bail-in. As such, the SRB has indicated that it will consider all liabilities governed by English law as eligible for the Tier 2 classification only until 28 June 2025. Should the FSAN fail to compel the Bank to address this capital deficiency now, the FSAN will shortly be faced with a significant impediment to its write-down and conversion powers, in addition to hampered resolution capabilities.

The solution adopted by other European banks in similar scenarios (and, we would suggest, clearly the only appropriate solution in these circumstances) has been for the bonds to be redeemed now. By way of example:

i. **ACAFP Float PERP – CMS (10y+2.5)**

Credit Agricole called these bonds on 25 October 2021, with the press release to investors stating that:

> *"In accordance with Articles 484 and 486 of Regulation (EU) no.575/2013 (as amended, the "CRR"), the 2007 Notes will lose, as from January 1, 2022, the benefit of the grandfathering clause which allowed for their recognition as Tier 1 capital."*[8]

Whilst those bonds had previously been treated as Additional Tier 1 Capital, the bank's Pillar 3 disclosures[9] listed various non-compliant features, including those set out below, which are evidently those which rendered the bonds ineligible as regulatory capital following the expiry of the relevant grandfathering provisions in December 2021:

(a) distribution under instruments on a non-fully discretionary basis; and

(b) a non-automatic obligation to write down the principal amount in accordance with the loss absorption clause upon the occurrence of a trigger event.

[8] Repayment of the Undated deeply subordinated notes | Crédit Agricole (credit-agricole.com)

[9] capital-instruments-main-features-at-31-december-2021-annexe-ii-.xlsx

ii. **BACA Float PERP – 10yrCMS+10 and BACA Float PERP – 10yrCMS+15**

Unicredit Austria called the above bonds on 28 April 2021 and 22 March 2021, respectively, though the press release is silent on the reasons for the bonds being called.[10] They were, however, previously treated as Additional Tier 1 (positioned as Tier 2 capital in subordination hierarchy in liquidation), with certain non-compliant features, including (i) a dividend pusher, and (ii) recapitalisation hindering.

The Pillar 3 disclosure document notes that the decision to redeem was taken as a result of those non-compliant features, with the reference to a "conservative interpretation" implying a dialogue between the bank and its supervisor having been undertaken:

"Due to conservative interpretation of Regulation (EU) 2019/876 (CRR II), Art. 494a, starting from 2Q19, instruments according to Art. 52 of Regulation (EU) 575/2013 issued through special purpose entities are no longer included as Additional Tier 1 according to the phase-out conditions of Regulation (EU) 575/2013, Art. 484. Instruments were called with following redemption dates: 22 March 2021 (DE000A0DYW70) and 28 April 2021 (DE000A0DD4K8)." [11]

iii. **BACR Float PERP Disco (L+100)**

Barclays called these bonds on 31 January 2022[12] on the basis on ineligibility post-transitional Basel III rules. Whilst the Pillar 3 disclosure is silent on the specific non-compliant features, it does note that the "*instrument had an incentive to redeem in the past."*[13] It is unclear what the incentive was or if indeed it was the potential infection risk which could have arisen absent the bonds being called.

iv. **Lloyds Banking Group Bonds**

A series of bonds, issued by Lloyds Banking Group entities, were called on 3 or 4 February 2022 as a result of the bonds' ineligibility as Additional Tier 1 capital as of 1 January 2022 following the end of the grandfathering provisions.

---

10 Call of DE000A0DD4K8 (bankaustria.at)

10 Call of DE000A0DYW70 (bankaustria.at)

11 offenlegung_kapitalinstrumente_art_437_crr_4Q20_en.pdf (bankaustria.at) page 11

12 20211209-Notice-of-Redemption-and-Cancellation-of-Listing.pdf (home.barclays)

13 Barclays PLC and Barclays Bank UK PLC Pillar 3 Disclosures Terms and Conditions 2020.pdf (home.barclays) page 5

The bonds are described as follows:

(a) Series B Perpetual Regulatory Tier One Securities

(b) Guaranteed Non-voting Non-cumulative Preferred Securities

(c) Guaranteed Non-voting Non-cumulative Preferred Securities

(d) Fixed-to-Floating Rate Perpetual Capital Securities

The press release regarding the redemption of the bonds specifically states that:

> *"Prior to 1 January 2022, each Series was eligible for classification as Additional Tier 1 Capital pursuant to the transitional provisions set out in Regulation (EU) No. 575/2013 on prudential requirements for credit institutions and investment firms of the European Parliament and of the Council of 26 June 2013, as it forms part of the domestic law of the UK by virtue of the European Union (Withdrawal Act) 2018.*
>
> *Each Series ceased as of 1 January 2022 to be eligible for classification as Additional Tier 1 Capital. The issuer of each Series is therefore exercising its right to redeem each such Series pursuant to their respective terms and conditions."* [14]

The Pillar 3 disclosure notes that each of the bonds were grandfathered in Additional Tier 1 to 2021 but are now ineligible post-transitional CRR rules. It specifically cites 'step-up' as the non-compliant feature of each of the bonds.

v. **NatWest Group – Dollar Perpetual Regulatory Tier One Securities, Series 1 ("PROs")**

These bonds were issued by NatWest and were called on 3 March 2022. The press release concerning the calling of the bonds[15] specifically notes that:

> *"Prior to 1 January 2022, the PROs were eligible for classification as Tier 1 capital of the Company under the bank capital regulations applicable to the Company. However, the PROs cannot be included in calculating the Company's Tier 1 capital after 31 December 2021 and accordingly the Company is redeeming the PROs pursuant to the redemption provisions of the Indenture."*

[14] Investegate |Lloyds Banking Group Announcements | Lloyds Banking Group: Notice of Regulatory and Capital Event Redemptions

[15] 2021-lbg-fy-pillar3-capital-instruments.xlsx

The Pillar 3 disclosure document notes that the bonds were classified as Additional Tier 1 capital under the transitional CRR rules and are ineligible post-transitional CRR rules. The disclosure also specifically notes that the bonds contain the following non-compliant features:

(1) Without loss-absorption trigger

(2) Step-up

(3) Dividend stopper

The bank has very clearly set out in the press release that the ineligibility of the bonds in the post-transitional CRR capital structure is the reason for the early redemption of these bonds and all of the PROs. The existence of the dividend stopper is also a concerning feature from the perspective of resolution authorities.

vi. **NatWest Group – Non-Cumulative Trust Preferred Securities ("TPSs")**

These bonds were issued by NatWest and the announcement of the intention to call the bonds was made on 1 February 2022. The press release concerning the calling of the bonds specifically notes that the bank intends to redeem all of the outstanding TPSs. It notes that:

> *"The Prudential Regulation Authority, which has primary responsibility for the prudential oversight and supervision of NWG, has confirmed that the TPSs can no longer be included in calculating NWG's Tier 1 capital on a solo and/or consolidated basis after December 31, 2021. Accordingly, NWG intends to redeem the TPSs under the terms and conditions governing the TPSs."*[16]

The Pillar 3 disclosure notes that the bonds were classified as Additional Tier 1 capital under the transitional CRR rules and are ineligible post-transitional CRR rules.[17] The disclosure also specifically notes that the bonds contain the following non-compliant features which renders them ineligible post-transitional CRR:

(a) Without loss-absorption trigger

(b) Step-up

(c) Dividend stopper

(d) No waiver of set-off rights

[16] Intention to Exercise Regulatory Call (investis.com)

[17] nwg-pillar-3-appendix-2021.pdf (natwestgroup.com) pg 2

The bank has very clearly set out in the press release that the ineligibility of the bond in the post-transitional CRR capital structure is the reason for the early redemption of these bonds and all TPSs.

b. The contractual provisions governing the Notes do not specify the subordination order in relation to eligible liabilities, which is a requirement for an instrument to qualify as Tier 2 under Article 63(d). Instead, Condition 1 of the Proposal concerning the DNB Notes refers to "*other subordinated creditors of the Bank except those whose claims rank, or are expressed to rank pari passu with or junior to the claims of the Noteholders*". This is plainly inadequate.

c. For the reasons further explained below, pursuant to Article 63(d), the claim on the principal amount of the instruments under the provisions governing the instruments must rank below any claim from eligible liabilities instruments. Similarly, under Article 63(f), the Notes cannot be subject to any arrangement, in whatever form, that would, in effect, enhance the senior of the claim under the instruments. However, given that the Notes include contractual provisions, or lack thereof, that may give them preferential treatment in an insolvency scenario, or may exclude them altogether from the scope of the bail-in tool, this results in, first, a material risk of litigation if the Notes were subject to the bail-in tool, and, second, the Notes raking *pari passu* with at least some of the instruments that may be subject to the bail-in tool or write-down and conversion powers, primarily the eligible liabilities instruments. In light of these arrangements, the Notes do not and cannot be classified as Tier 2 instruments; and

d. The Trust Deed of the Bergen Notes at Condition 6 of Schedule 2 and the Proposal for the DNB Notes at Condition 5 allow the Bank to "*purchase beneficially for its account Notes at any price…in the open market or otherwise. Notes so purchased may be held or re-sold or surrendered for cancellation*". The option for the Bank to purchase its own bonds is plainly inconsistent with the provisions of Article 63(k), and disqualifies the Notes from being classified as Tier 2 bonds.

22. For these and other reasons, the Notes do not satisfy the requirements of Tier 2 capital instruments. The fact that the Bonds cannot be classified as Tier 2 is significant as it directly impacts the FSAN's power to (i) write down or convert relevant capital instruments under Article 59 of the BRRD II, and (ii) exercise its bail-in powers under Article 44 of the BRRD II . In other words, should the Bank be failing, the FSAN would have significantly fewer loss absorbing instruments to write down or convert, thereby risking the financial stability of the Norwegian market. This would, in turn, likely lead to the resolution of DNB, which would result in significantly higher losses to creditors. As such, given the Notes' ineligibility as Tier 2 capital instruments, the FSAN should exercise its powers under Article 17 of the BRRD II and compel DNB to call the Notes immediately.

The Notes pose an impediment to resolution because they do not satisfy the requirements for the MREL standard and risk infecting other capital instruments

23. As described above, one of the most prominent objectives of the new regulatory regime after the 2008 financial crisis has been to ensure that national resolution authorities can

resolve failing institutions with ease and speed. In that respect, the FSB's Term Sheet set out guidelines on the impact of certain characteristics on TLAC-eligibiliity of instruments. For example, Section 11 sets out the importance of 'priority' and states that:

> "*Eligible TLAC generally must absorb losses prior to liabilities excluded from TLAC in insolvency or in resolution and, in all cases, without giving rise to material risk of successful legal challenge or valid compensation claims; and authorities must ensure that this is transparent to creditors.*
>
> *To ensure that eligible external TLAC absorbs losses prior to liabilities that are excluded from TLAC (see Section 10) and therefore to support the aim of ensuring that the [global systemically important bank] is credibly and feasibly resolvable, eligible instruments must be:*
>
> *(a) contractually subordinated to excluded liabilities on the balance sheet of the resolution entity ("contractual subordination");*
>
> *(b) junior in the statutory creditor hierarchy to excluded liabilities on the balance sheet of the resolution entity ("statutory subordination"); or*
>
> *(c) issued by a resolution entity which does not have any excluded liabilities (for example, a holding company) on its balance sheet that rank pari passu or junior to TLAC-eligible instruments on its balance sheet ("structural subordination").*
>
> *.....*
>
> *To assess the risk of legal challenge, authorities should consider, among other things, (i) the amount of excluded liabilities, if any, that rank pari passu to TLAC in any given creditor class; (ii) the applicable resolution law for the resolution entity; and (iii) the agreed resolution strategy for the resolution entity.*"

24. In short, the FSB recognised the risks associated with capital instruments that would need to be excluded from the TLAC requirement but could give rise to issues for other bonds in the hierarchy.

25. Equally, the EBA considered questions of eligibility for MREL purposes when it issued technical standards back in 2015 (the "**Regulatory Technical Standards**" or the "**RTS**"). Although referring to the BRRD I, the EBA's guidance on the circumstances in which certain liabilities might be excluded remain instructive under the BRRD II. In 2015, the EBA said that:

> "*in a bail-in, some liabilities are not eligible under Article 44(2) of the BRRD, or resolution authorities may make use of their power under Article 44(3) of the BRRD to exclude some classes of liabilities on an ad-hoc basis, or they may be transferred in full under a partial transfer*".

26. It logically follows that if a liability is excluded, then the MREL requirement should be increased in order to allow for this exclusion. In other words:

"…exclusion of liabilities from loss increases the amount of loss or recapitalisation which must be borne by other liabilities. If a sufficiently large amount of excluded liabilities rank equal to or junior to in terms of insolvency any liabilities which are bailed in, this could result in holders of bailed-in liabilities receiving worse treatment than in insolvency, and so being eligible for compensation".

27. The EBA cautioned that in these circumstances the no-creditor-worse-off ("**NCWO**") could be triggered through the exclusion of liabilities, which is best represented in the following illustrative example that the EBA included in the RTS:

Box 2: Stylised example of the impact of exclusions

A failing bank has assets of 1 000 (RWA of 500); equity of 50 (CET1 10%); senior debt of 50; large corporate transaction deposits of 50, which rank *pari passu* with senior debt; and 850 in preferred retail deposits. The resolution authority concludes that bailing in corporate transaction accounts would interrupt the operation of a critical function, and so they should be excluded from bail-in under the resolution plan.

A loss of 50 would require writedown of all of the old equity. Conversion of 100% of the senior debt would, assuming the average risk weight of assets does not change, restore the CET1 capital ratio to 10.5%. If the economic value of the equity after resolution is 80% of book value, the economic loss to the former senior creditors would be 10.

Under insolvency, half of this loss would have been borne by the corporate transaction deposits. If the ex post insolvency valuation concludes that total losses in insolvency would have been 70 or less, then senior debt holders would be worse off than in insolvency. To reduce this, the MREL requirement could be raised (provided this is met through liabilities which can be feasibly and credibly bailed in), or part of the MREL requirement could be met through subordinated bail-in-able liabilities, in both cases increasing the proportion of losses in insolvency that are borne by MREL holders.

28. With this in mind, Article 3 of the RTS identified exclusions from bail-in or partial transfer which are an impediment to resolvability. In that respect, national resolution authorities are required to identify any class of liability which is reasonably likely to be fully or partially excluded from bail-in under Article 44(2) or (3) of the BRRD I (which remained, in large parts, unchanged in the BRRD II). To the extent such liabilities exist, the resolution authority shall determine whether they rank equally or junior in the insolvency creditor hierarchy which qualifies for inclusion in MREL and whether the amount of liabilities identified totals more than 10% of any one class of liabilities which ranks equally in insolvency. Given the Notes' lack of a contractual bail-in and the applicable principles of English law, it may not be possible for the FSAN to bail-in these liabilities within a reasonable time.

29. To this end, we know that the Notes form around 20% of the Bank's Tier 2 capital. In addition to not being able to a subject of an effective write-down or conversion, if they cannot effectively be bailed-in, as they do not satisfy the MREL requirements, this represents a significant impediment to resolution that should be addressed by the FSAN immediately under Article 17 of the BRRD II.

30. Indeed, the EBA acknowledged there was an infection risk with legacy bonds, such as the Notes, primarily in two areas. The first area of concern relates to the flexibility of distribution payments, specifically divided stoppers, dividend pushed, and reverse stopped. Given the contractual terms of the Notes, the FSAN need not be concerned with these. However, the second area of concern, namely that of subordination, becomes more prominent in the present scenario. Indeed, the subordination issue could arise in circumstances where the instrument has contractual provisions that mean that it does not sit within the subordination hierarchy consistent with the regulatory classification but could still qualify as MREL (albeit at a lower level), or the instrument is disqualified from MREL. The same concerns were addressed by UK the Prudential Regulatory Authority.[18]

31. Whilst there are no contractual bail-in provisions, we note that there are clear provisions that would cause the bonds to be converted to preference shares in a resolution or liquidation. In this event, at least contractually, the bonds would have a claim in liquidation equal to their nominal value plus accrued interest.

32. Whilst in an insolvency the Notes would rank *pari passu* with other T2 bonds the exemption from a bail-in means that they would be treated differently in resolution. This asymmetric treatment causes a lack of legal certainty and transparency, both of which are contrary to the FSB principles set out above.

33. These issues become a barrier to resolution in that the FSAN (in its capacity as resolution authority) is faced with an unenviable choice. It can either (i) attempt to bail-in the Notes and potentially face litigation in the English Court for the reasons set out below; or (ii) accept that these Notes are exempt from bail-in and should be excluded. This exclusion gives rise to a threat of litigation from holders of Other T2 bonds.

34. To illustrate the issue, if the FSAN was required to manage DNB at the point of non-viability and exercise its resolution powers, it might well choose to exercise its bail-in powers to ensure the continuation of DNB's critical functions in light of its systemically important role for Norway, in addition to the write-down and conversation powers. At present, assuming that the Notes do satisfy the Tier 2 requirements (which our Clients' dispute), DNB has various Other Tier 2 instruments on its balance sheet. In practical terms, this means that the Tier 2 instruments issued after 2014 will likely be significantly more resolvable than the Notes.

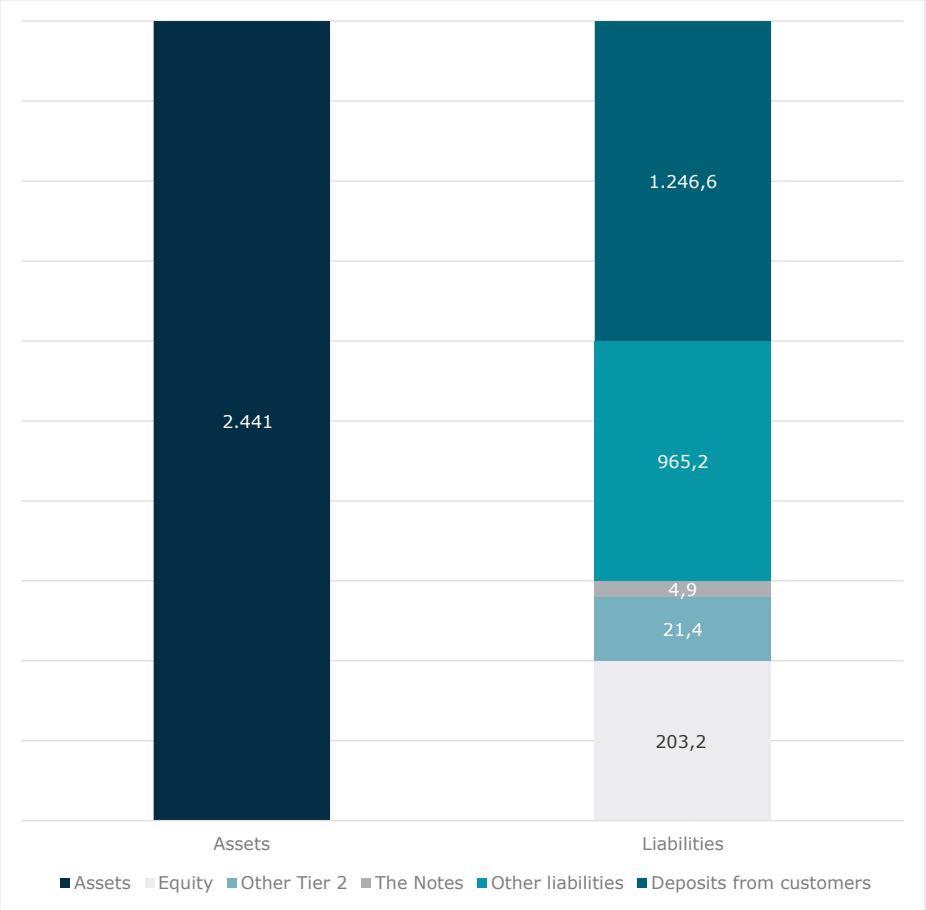
35. The consequences of this situation are two-fold. **First**, the holders of the Tier 2 instruments that would be bailed-in would be treated differently in a resolution context. This outcome goes against the principle that all Tier 2 instruments must face the same treatment in resolution and/or any insolvency proceedings. **Second**, this difference in treatment would likely lead the affected Other Tier 2 holders to launch legal

[18] Letter from Sarah Breeden: Remediation of prudential treatment of legacy instruments before CRR I transition period ends (bankofengland.co.uk).

proceedings, as they would suffer losses greater than investors whose investments allegedly ranked *pari passu* and were expected to share losses equally in an insolvency. This is inconsistent with the NCWO principle.

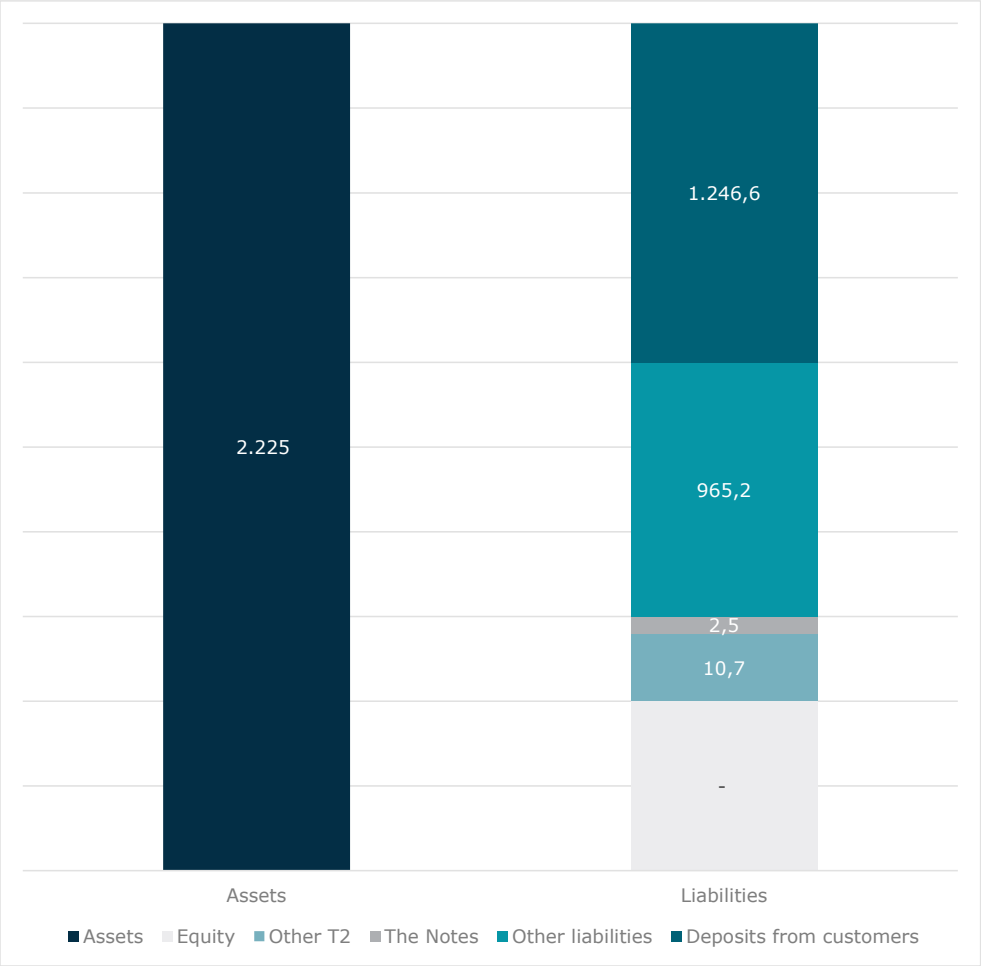
36. In graphical terms, DNB's current capital structure can be summarised as:

Chart 1: DNB Bank ASA (pre intervention), March 2022 (not to scale)



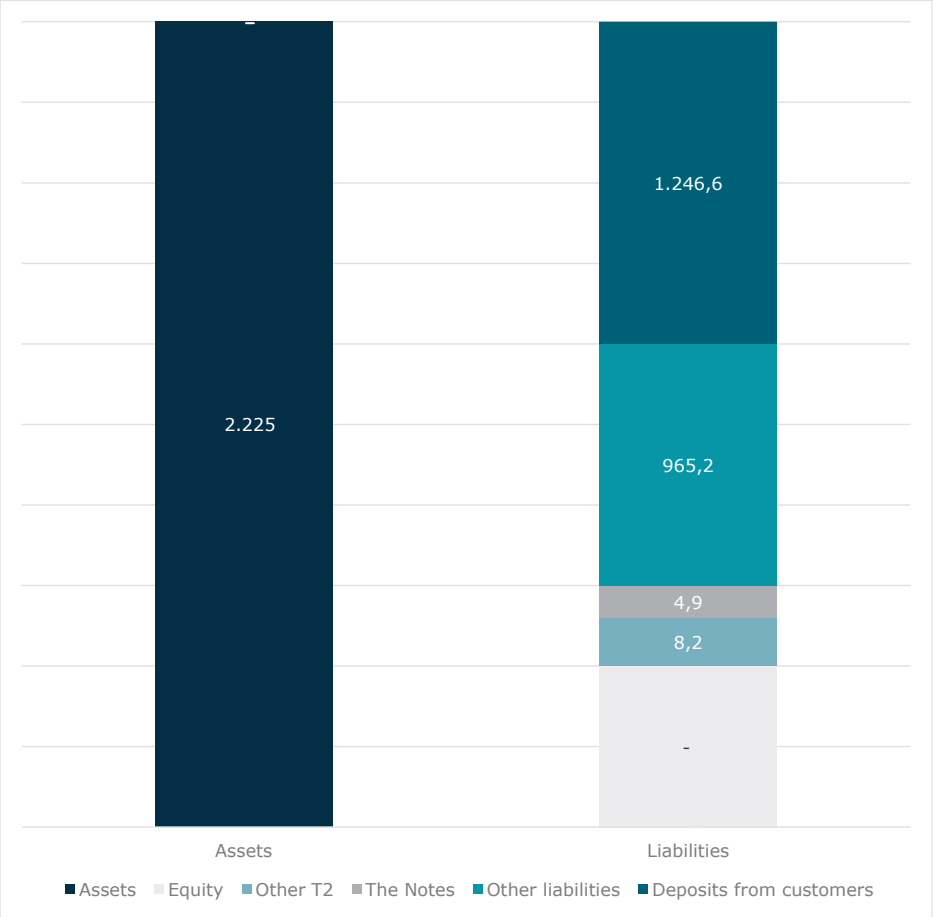
37. In a scenario where the Bank suffers a significant loss, such that the Bank becomes non-viable and the FSAN determined that 50% of the Bank's Tier 2 instruments should be bailed-in, all holders of Tier 2 bonds would be treated equally where they can all be bailed-in.

Chart 2: DNB Bank ASA (Symmetric bail-in) March 2022 (not to scale)



38. If FSAN were to adopt the alternative strategy and choose not to bail-in the Notes on the basis that they do not have a contractual bail-in mechanism, the losses suffered by Other Tier 2 holders exposed to the bail-in would be greater, as can be seen from the chart below where the holding of other Tier 2 instruments decreased from NOK 21.9 bn to NOK 8.2 bn.

Chart 3: DNB Bank ASA (Asymmetric bail-in) March 2022 (not to scale)



39. In this example, the holders of Other T2 bonds suffer greater losses than the holders of the Notes, which were insulated from all losses. In this scenario, it is more likely than not that the Other T2 bond holders would commence legal proceedings. Such an outcome would undermine the resolution objectives. As such, it represents an impediment that must be corrected by the FSAN through the exercise of its powers under Article 17 of the BRRD.

The Notes may pose an impediment to resolution because the issuances included retail distributions

40. The possibility of certain of the Bonds being held by retail investors cannot be excluded in circumstances where the Bonds were (i) issued, at least in part, as bearer securities, and (ii) bought and sold on exchange in ticket sizes with a nominal value of $10,000.

41. The various complications associated with retail issuances have long been a sources of concern for both resolution authorities and supervising authorities, with the proportion of retail holdings having the potential to constitute an impediment to resolution for predominantly two reasons:

    a. *Differing investment strategies:* this refers, above all, to the fact that retail investors tend to invest over a longer period than institutional investors, thus

providing a longer-term, more stable source of income to issuers, such that a decision to bail-in retail investors has the potential to have more significant implications for both long term investment generally, and banking in particular.

b. *An imbalance of knowledge and understanding:* it is generally the case that institutional investors, with greater access to advice, resources, and specialised knowledge are considered to be more knowledgeable than retail investors as to the nature and, in particular, the risk associated with investments. Where that is the case, there is a clear risk of litigation arising as a result of retail investors not having properly comprehended the risk of their investments being bailed-in.

42. It is clear from the above that any potential capital benefit arising from bail-in is outweighed by the real risk of franchise damage to and litigation against the Bank. This was a point acknowledged and accepted by the European Commission in its consideration of the financial assistance programme provided to Spain in 2012-2014:

> "*The bail in of hybrid capital and subordinated liabilities, while reducing the cost to the taxpayer, to a significant degree hit domestic retail investors and led to social unrest… Where burden sharing is going to be implemented within a programme, there is merit in taking into account the programme's impact on consumers and retail investors."*[19]

43. That clearly envisages the need for differing treatment being given to the two types of investors, though the options available to the authority in such circumstances are clearly unsatisfactory.

a. Whilst one possible approach may be to treat retail bondholders as depositors (ignoring legal subordination), the obvious impact of this is to concentrate the impact of bail-in on institutional investors. That gives rise to a further material risk of litigation.

b. The other alternative that has been considered, notably by the Italian authorities, is that of providing compensation to retail investors:

i. In the case of the recapitalisation of Monte de Paschi in 2017, the Italian treasury committed to "compensate retail bondholders who had bought the bank's junior debt without being fully aware of the risks."[20]

ii. In the case of Banca Marche Banca Etruria, CariChieti and CariFe, in 2015, the Italian Government, supported by the European Commission, took the decision to compensate retail bondholders; and

[19] **Error! Hyperlink reference not valid.**

[20] https://www.reuters.com/article/us-eurozone-banks-italy-montepaschi/monte-paschi-says-offer-to-swap-retail-bondholders-shares-delayed-idUSKBN1CY0TN

iii. While subordinated bondholders in the Veneto banks were bailed-in, its retail bondholders were compensated via the fund set up in respect of the four banks referred to above.

44. The presence of material holdings by retail investors in the Bonds would, in a resolution context, leave the FSAN faced with three options:

a. Bail-in all of the Bonds, whether held by retail investors or institutional investors, and expose the recapitalised bank to the risk of litigation;

b. Discriminate between the two by only bailing-in Bonds held by institutional investors, causing them to carry the burden which would otherwise be carried by the retail investors that had been excluded; or

c. Bail-in all of the bonds, compensating retail investors with taxpayer-sponsored compensation.

45. The various drawbacks associated with these options speak for themselves, clearly outweighing the economic benefits of any future bail-in.

As a matter of English law, any attempt to resolve or otherwise compromise the Notes may be legally impossible

46. Following the United Kingdom's decision to leave the European Union, the legislation applicable in the European Union and the EFTA countries is no longer automatically recognised as binding and enforceable under the law of England and Wales. It follows that decisions of any regulatory bodies that apply and conform to EU law, including the FSAN (which applies EU law by virtue of Norway's membership in the EFTA) will not be automatically enforceable by the relevant institutions in the United Kingdom, most notably the Bank of England.

47. In the absence of any applicable treaty, English law provides that foreign law discharge of an English law governed contractual debt or obligation is of no effect as a matter of English law. In other words, foreign law cannot discharge a debtor from its obligations under English law, unless English law recognises the measures taken under foreign law as enforceable under English law (*Antony Gibbs & Sons v La Société Industrielle et Commerciale des Métaux* (1890) LR 25 QBD 399) (the "**Gibbs Principle**"). As explained more recently by the Supreme Court of the United Kingdom in *Goldman Sachs International v Novo Banco SA Guardians of New Zealand Superannuation Fund v Novo Banco SA* [2018] UKSC 34 in relation to a stabilisation measure taken by the Portuguese national resolution authority:

> "*The rescue of failing financial institutions commonly involves measures affecting the rights of their creditors and other third parties. Depending on the law under which the rescue is being carried out, these measures may include the suspension of payments, the writing down of liabilities, moratoria on their enforcement, and transfers of assets and liabilities to other institutions. At common law measures of this kind taken under a foreign law have only limited effect on contractual liabilities governed by English law.* ***This is because the discharge or***

> ***modification of a contractual liability is treated in English law as being governed only by its proper law, so that measures taken under another law, such as that of a contracting party's domicile, are normally disregarded***" (at paragraph 12, emphasis added).

48. The Notes "*are governed by, and shall be construed in accordance with, English law, save that Condition 1 above, and the provisions of the Trust Deed in so far as they relate to the matters provided for in Condition 1, are governed by, and shall be construed in accordance with, Norwegian law*". Condition 1 sets outs the Notes' status as "*unsecured obligations*" and their subordinated nature to "*Senior Creditors*". The debt obligations, however, are set out in Conditions 4-6 and are governed by English law. As such, the Gibbs Principle is engaged and the FSAN must be alive to the possibility that its stabilisation measures with respect to the DNB may not be recognised in the United Kingdom.

49. Indeed, following the United Kingdom's exit from the EU and the non-applicability of the EU Insolvency Regulation (Regulation 2015/848) as a result, the Bank of England now enjoys discretion as to whether to recognise "*third-country resolution action*" under Section 89H of the Banking Act 2009. In practical terms, this change in the legislation now translates into a requirement for the Bank of England to take a positive step to recognise any action taken by the FSAN to manage the failure or likely failure of the Bank, including the FSAN's write-down and conversion powers, in addition to its competence to apply the bail-in tool. There is, therefore, a risk that the FSAN's measures would not be recognised as a matter of course and as a matter of English law, Consequently, the contractual debt would continue to exist, the Noteholders would be able to sue on that debt in the English Court and be granted judgment thereon, and the resolution action by the FSAN would ultimately be undermined.

50. The importance of resolvability under third country law cannot be overstated. As explained by the SRB, "*a third country with jurisdiction over the liabilities may not recognise the resolution actions of an EU resolution authority [Norway included in light of the EEA agreement]. In such circumstances resolution that achieves the objectives of the SRM [i.e., Single Resolution Mechanism] will be at risk*".[21]

Conclusion

51. For the reasons set out above, the FSAN should consider the steps it could take to minimise the risk of non-recognition and non-enforceability. The most appropriate means of extinguishing that risk, particularly in light of the other challenges posed in relation to the suitability of the Notes as Tier 2 capital instruments, would be to require DNB to call the Notes immediately and to order the Bank to issue new regulatory capital that is compliant with the banking standards in force today. This is not only prudent, but aligned with the approaches of other authorities, including the 2020 recommendations of the EBA.[22]

---

[21] Minimum Requirement for Own Funds and Eligible Liabilities (MREL) / SRB Policy under the Banking Package (europa.eu), p. 31.

[22] EBA-Op-2020-17 Opinion on legacy instruments.pdf (europa.eu)

52. Our Clients would welcome the opportunity to discuss these matters further with the FSAN, and trust that they will be accorded the opportunity to do so fairly and openly, despite the FSAN's longstanding relationship with the Bank. We look forward to hearing from you.

Yours faithfully,

[redacted]

QUINN EMANUEL URQUHART & SULLIVAN UK LLP

cc:

DNB Bank ASA
P.O. Box 1600 Sentrum
FAO: [redacted]